

THE PROBLEM OF THE RUPEE: ITS ORIGIN AND ITS SOLUTION

(HISTORY OF INDIAN CURRENCY & BANKING)

CHAPTER VI STABILITY OF THE EXCHANGE STANDARD

It will be recalled that at the time the Indian Mints were closed to the free coinage of silver there were two parties in the country, one in favour of and the other opposed to the closure. Being placed in an embarrassing position by the fall of the rupee, the Government of the day was anxious to close the Mints and raise its value with a view to obtaining relief from the burden of its gold payments. On the other hand it was urged, on behalf of the producing interest of the country, that a rise in the exchange value of the rupee would cause a disaster to Indian trade and industry. One of the reasons, it was argued, why Indian industry had advanced by such leaps and bounds as it did during the period of 1873-1893 was to be found in the bounty given to the Indian export trade by the falling exchange. If the fall of the rupee was arrested by the Mint closure, it was feared that such an event was bound to cut Indian trade both ways. It would give the silver-using countries a bounty as over against India, and would deprive India of the bounty which it obtained from the falling exchange as over against gold-using countries.

Theory had already scoffed at these fears. It is therefore interesting to see that later history has also confirmed the verdict of theory. Indian trade with a gold-standard country like England or a silver-standard country like China did not suffer a setback, notwithstanding an arrest in the fall of the rupee. The following figures furnish sufficient evidence to support the contrary:—

TABLE XXV
TRADE OF INDIA WITH UNITED KINGDOM (BEFORE AND
AFTER THE MINT CLOSURE)

| Annual Average | Exports to U.K. | | | Imports from U.K. | | |
|----------------|------------------|-----------------------|------------|-------------------|-----------------------|------------|
| | Merchandis e. | Bullion and Specie | Total. | Merchandi se. | Bullion and Specie | Total. |
| | £ | £ | £ | £ | £ | £ |
| I1889-93 | 31,569,891 | 1,180,646 | 32,750,537 | 31,837,482 | 7,694,149 | 39,531,631 |
| II1894-98 | 26,329,764 | 2,215,049 | 24,544,813 | 28,963,180 | 6,750,736 | 35,713,916 |

| | | | | | | |
|---|------------|-----------|------------|------------|-----------|------------|
| III 1899-1903 | 28,709,819 | 2,089,656 | 30,799,475 | 33,498,480 | 7,301,172 | 40,799,652 |
| IV 1903-8 | 36,784,628 | 2,232,857 | 39,017,485 | 47,294,311 | 9,586,706 | 56,881,017 |
| Percentage of Increase (+) | | | | | | |
| or Decrease (—) in— | | | | | | |
| Period II in comparison with Period I | -16.598 | +87.613 | -25,055 | -9.28 | -12.261 | -9.657 |
| Period III in comparison with Period II | +9.039 | -5.661 | +25.483 | +15.659 | +8.154 | +14.240 |
| Period IV in comparison with Period III | +28.126 | +6.853 | +26.682 | +41.183 | +31.304 | +39.415 |
| Period IV in comparison with Period I | +16.518 | +89.122 | +19.135 | +48.549 | +24.597 | +43.887 |

TABLE XXVI
TRADE OF INDIA WITH CHINA

| Annual Average. | Exports to China. | | | Imports from China. | | |
|---|-------------------|----------|------------|---------------------|-----------|-----------|
| | Merchandise. | Treasure | Total. | Merchandise. | Treasure | Total. |
| | £ | £ | £ | £ | £ | £ |
| I 1889-93 | 9,454,014 | 20,223 | 9,474,238 | 1,666,840 | 1,992,914 | 3,659,754 |
| II 1893-98 | 8,509,284 | 112,105 | 8,621,389 | 1,713,529 | 503,357 | 2,216,886 |
| III 1898-1903 | 9,679,830 | 183,647 | 9,863,477 | 1,309,975 | 798,053 | 2,108,028 |
| IV 1903-8. | 12,461,535 | 160,879 | 12,622,414 | 1,248,822 | 919,402 | 2,168,224 |
| Percentage of Increase (+) | | | | | | |
| or Decrease (—) in— | | | | | | |
| Period II in comparison with Period I | -9.993 | +454.333 | -9.002 | +2.801 | -74.743 | -39.425 |
| Period III in comparison with Period II | +13.756 | +63.817 | +14.407 | -23.551 | +58.546 | -4.910 |

| | | | | | | |
|---|---------|----------|---------|---------|---------|---------|
| Period IV in comparison with Period III | +28.737 | - 12.398 | +27.971 | - 4.668 | +15.206 | + 2.856 |
| Period IV in comparison with Period 1 | +31.812 | +695.508 | +33.229 | -25.078 | -53.866 | -40.755 |

That the arrest in the fall of the rupee should have lifted the burden from Indian finances was just as was expected to follow from the closure of the Mints. Notwithstanding important reductions in taxation and large expenditure of social utility, the annual budgets since the mint closure have shown few deficits (see p. 506).

Now there is a tendency among some writers to interpret these facts as unmistakable proofs of the soundness of the currency system. It is argued that if the trade of the country has not received a setback, and if the finances of the country have improved, then the implication is that the currency of which such results can be predicated must be good. It is not necessary to warn students of currency that such easy views on the soundness of the currency system, however plausible, are devoid of the logic necessary to carry conviction. Trade no doubt is dependent on good money, but the growth of trade is not a conclusive proof that the money is good. It should be noted that during the periods of debased coinages so common at one time the social misery and nuisance arising therefrom were intolerable, yet during the same periods it was possible for countries to make great advance in trade. Speaking of seventeenth-century England, when that country was afflicted with debased and constantly changing coinage and when there was, besides, a long period of civil war and confusion, Lord Liverpool, who was above all statement of his day most alive to the evils of a bad currency, remarks:—

" It is certain, however, that during the whole of this period, when our coins were in so great a state of confusion, the commerce of the kingdom was progressively improving and the balance of trade almost always in favour of this country." That commerce can increase even when currency is bad is easily supported from the experience of India herself. In no period did Indian trade make such strides as it did between 1873 and 1893. Was the Indian currency of that period good ? On the other hand, it is possible to hold that if trade is good it may be *because* the currency is bad. The trade of India between 1873 and 1893 flourished because it received a bounty. But the bounty was a mulcting of the Indian labourer, whose wages did not rise as fast as prices, so that the Indian prosperity of that period was founded not upon production, but upon depredation made possible by the inflation of currency.

TABLE XXVII
FINANCES OF THE GOVERNMENT

| Years. | Surplus + Deficit — | Years. | Surplus + Deficit— | Years. | Surplus + Deficit — | Years. | Surplus + Deficit— | Years. | Surplus + Deficit— |
|---------|------------------------|---------------|-----------------------|--------|------------------------|---------|-----------------------|---------|-----------------------|
| | Rs | | £ | | £ | | £ | | £ |
| 1893-94 | -1,546,998 | 1898-9 | +2,640,873 | 1903-4 | +2,996,400 | 1908-9 | -3,737,710 | 1913-14 | +2,312,423 |
| 1894-95 | + 693,110 | 1899- 1900 | +2,774,623 | 1904-5 | +3,456,066 | 1909-10 | + 606,641 | 1914-15 | -1,785,270 |
| 1895-96 | +1,533,998 | 1900-1 | +1,670,204 | 1905-6 | +2,091,854 | 1910-11 | +3,936,287 | 1915-16 | -1,188,661 |
| 1896-97 | -1,705,022 | 1901-2 | +4,950,243 | 1906-7 | +1,589,340 | 1911-12 | +3,940,334 | 1916-17 | +7,478,170 |
| 1897-98 | -5,359,211 | 1902-3 | +3,069,549 | 1907-8 | + 300,615 | 1912-13 | +3,107,634 | — | — |

Similarly it cannot be granted without reserve that the new currency system must be good because it has obviated the burden of the gold payments and given relief to the Indian taxpayer. Such a view involves a misconception of the precise source of the burden of India's gold payments during the period of falling exchange. It has been widely held that the burden of gold payments was caused by the fall in the gold value of silver, a view which carried with it the necessary implication that if India had been a gold-standard country she would have escaped that heavy burden. That it is an erroneous view hardly needs demonstration. It is not to be denied that India bore an extra burden arising from the increased value of the gold payments. But what is not sufficiently realised is that it was a burden which weighed on all gold debtors irrespective of the question whether their standard was gold or silver. In this respect the position of a gold-standard country like Australia was not different from a silver-standard country like India. In so far as they were gold debtors they suffered each in the same way from the same cause, namely the appreciation of the standard in which their debts were measured. The fact that one discharged her debts in gold and the other in Silver made no difference in their condition, except that the use of silver by India to discharge her debts served as a refractory medium through which it was possible to see the magnitude of the burden she bore. The fall of silver measured and not caused the burden of India's gold payments. The arrest in the fall of the rupee cannot be accepted as a *prima fade* proof of a relief to the taxpayer and therefore an evidence of the soundness of the currency system. It is possible that the benefit may have been too dearly paid for.

Although favourably impressed by the increase of trade and the buoyancy of Government finances under the exchange standard, the Chamberlain Commission did not care to found its case for it on the basis of such arguments.

The chief ground on which it rested was that the currency system was capable of maintaining the exchange value of the rupee at a fixed par with gold. We must therefore proceed to examine this claim made by the Commission on behalf of the exchange standard. The table No. XXVIII presents the requisite data for an elucidation of the question.

TABLE XXVIII
GOLD
VALUE OF THE RUPEE

| As expressed in Terms of Foreign Exchange Rates on London. Par R.= ls.4d. | | | As expressed In Terms of Gold. | | | | |
|---|----------|---------|--------------------------------|--|-----------|--|-----------|
| | | | Years. | (1) Rupee Price of Sovereigns. Par Rs. 15 = 1 Sovereign. | | (2) Rupee Price of Bar Gold. Par Tola = Rs. 23-14-4. | |
| Years. | Highest. | Lowest. | | Highest. | Lowest. | Highest. | Lowest. |
| | s. d. | 8. d. | | Rs. A. P. | Rs. A. P. | Rs. A. P. | Rs. A. P. |
| 1892-93 | 1 3.969 | 1 2.625 | 1893 | 16 10 6 | 15 6 0 | 26 11 0 | 24 14 0 |
| 1893-94 | 1 4.031 | 1 1.500 | 1894 | 19 0 0 | 16 1 0 | 32 4 0 | 25 9 0 |
| 1894-95 | 1 1.906 | 1 0.000 | 1895 | 19 5 0 | 18 2 6 | 30 8 0 | 27 6 0 |
| 1895-96 | 1 2.875 | 1 1.000 | 1896 | 17 7 0 | 16 1 0 | 27 13 6 | 27 2 0 |
| 1896-97 | 1 3.842 | 1 1.781 | 1897 | 16 10 0 | 15 3 0 | 26 12 6 | 25 4 0 |
| 1897-98 | 1 4.125 | 1 2.250 | 1898 | 15 7 0 | 15 1 0 | 24 10 0 | 24 0 0 |
| 1898-99 | 1 4.156 | 1 3.094 | 1899 | 15 4 0 | 15 0 0 | 24 2 0 | 23 4 0 |
| 1899-1900 | 1 4.375 | 1 3.875 | 1900 | 15 1 3 | 15 0 0 | 24 2 0 | 23 15 6 |
| 1900-1901 | 1 4.156 | 1 3.875 | 1901 | 15 0 0 | 15 0 0 | 24 2 0 | 24 0 0 |
| 1901-1902 | 1 4.125 | 1 3.875 | 1902 | 15 4 6 | 15 2 6 | 24 2 6 | 24 0 0 |
| 1902-1903 | 1 4.156 | 1 3.875 | 1903 | 15 3 0 | 15 1 6 | 24 3 0 | 24 0 0 |
| 1903-1904 | 1 4.156 | 1 3.875 | 1904 | 15 5 0 | 15 1 3 | 24 2 0 | 24 0 3 |
| 1904-1905 | 1 4-156 | 1 3-970 | 1905 | 15 4 0 | 15 1 6 | 24 2 0 | 24 0 0 |
| 1905-1906 | 1 4-156 | 1 3-937 | 1906 | 15 1 0 | 15 2 0 | 24 4 6 | 24 0 0 |
| 1906-1907 | 1 4-187 | 1 3-937 | 1907 | 15 4 0 | 15 0 0 | 24 4 0 | 23 15 6 |
| 1907-1908 | 1 4-187 | 1 3-875 | 1908 | 15 1 0 | 15 0 0 | 24 10 0 | 24 2 0 |
| 1908-1909 | 1 4 | 1 3-875 | 1909 | Premium between 12 and 3% | | 24 3 6 | 23 15 0 |
| 1909-1910 | 1 4-156 | 1 3-875 | 1910 | 15 5 0 | 15 0 0 | 24 4 0 | 23 15 0 |
| 1910-1911 | 1 4-156 | 1 3.870 | 1911 | 15 0 0 | 15 0 0 | 24 0 6 | 23 14 0 |
| 1911-1912 | 1 4-156 | 1 3-937 | 1912 | 15 0 0 | 15 0 0 | 24 0 0 | 23 14 0 |
| 1912-1913 | 1 4-156 | 1 3-970 | 1913 | 15 0 0 | 15 0 0 | 24 0 3 | — |
| 1913-1914 | 1 4.156 | 1 3-937 | 1914 | 15 14 0 | 15 2 0 | 26 10 0 | 23 15 6 |

| | | | | | | | |
|-----------|---------|---------|------|----------|--------|---------|--------|
| 1914-1915 | 1 4-094 | 1 3-937 | 1915 | 15 13 6. | 15 5 0 | 25 14 0 | 24 8 0 |
|-----------|---------|---------|------|----------|--------|---------|--------|

Assuming, for the moment, the criterion laid down by the Commission to be correct, can it be said from the data given above that the rupee has maintained its gold value ? It would be over-confident if not rash to say that the system, even from the narrow point of view of the Commission, has been an unquestioned success.

Between June, 1893, and January, 1917, the rupee was rated to gold at the rate of 1 rupee equal to 7.53344 troy grs. of fine gold. At that rate the sovereign should be equal to 15 rupees, the mint price of gold should be Rs. 23-14-4 per tola (i.e. 180 grs.) of bar gold 100 touch, and the exchange on London should be 1s. 4d., and should have varied within 1s. 4.125 d., the import point, and 1s. 3.906 d., the export point, for gold.

Taking a general survey of the stability of the rupee with regard to its value in terms of gold, it will be noticed that from the date of the Mint closure up to 1898 the rupee was far below par. The depreciation of the rupee, measured in terms of exchange or price of gold or sovereign, ranged somewhere between 25 to 30 per cent. So great was the depreciation that it redoubled the difficulties confronting the Government when the rupee was not fixed to gold. The financing the Home Treasury by the usual means of selling Council Bills became well-nigh impossible. The Secretary of State found himself in an embarrassing position. Offering to sell below par involved the obloquy of having led the way to the defeat of the policy of stabilising exchange. Refusing to sell at market rates involved the danger of a dry Treasury. The Government of India suggested that the Secretary should lay down a minimum rate for or a maximum amount of the bills that he put upon the market. The Secretary of State agreed to neither, but consented to reduce his drawings so as not to unduly depress the exchange rate. The drawings of the secretary of State during the first fiscal year since the Mint closure have been the smallest on record:—

TABLE XXIX Council Drawings

| Date of drawing | Amount of Drawings 1.000 omitted | Rate at which drawn (Pence per Rupee) |
|-----------------|----------------------------------|---------------------------------------|
| 1893. June | 2,478 | 15.039 |
| July | 25 | 15.974 |
| August | 78 | 15.243 |
| September | 7 | 15.350 |
| October | 5 | 15.334 |

| | | |
|---------------|-------|--------|
| November | 617 | 15.251 |
| December | 14 | 15.242 |
| 1894. January | 98 | 14.408 |
| February | 1,023 | 13.787 |
| March | 1,915 | 13.870 |
| April | 1,368 | 13.626 |

The curtailment of drawings to save the rate of exchange from being lowered was not an unmitigated good, for it imposed the necessity of a resort to the by no means inexpensive method of sterling borrowings to finance the Home Treasury. The remittances by drawings fell short of the net disbursements of the Home Treasury in 1893-94 by £6,588,000, which deficit was met by permanent sterling borrowings to the extent of £7,430,000, the interest on which added to the already overheavy burden of the gold payments. Rather than incur such a penalty the Secretary of State gave up the attempt to dominate the market and preferred to follow it. But this let-go policy was not without its cost. The drop in the exchange below 1s. 4d. added to the burden of remittances to the Home Treasury, and also compelled the Government to grant exchange compensation allowance to its European officers, civil and military—an aid which it had so far withheld. The cost to the Government involved by the fall of the rupee below par was quite a considerable sum.

TABLE XXX

Cost of the Fall of the Rupee

| Years | Loss on | Loss by | Loss by | Total on each | Total on all Counts for | |
|---------|---------------|--------------|----------------|---------------|-------------------------|------------------------|
| | Council Bills | Exchange | Increase of | | three Years | |
| | being sold | Compensation | Pay of | Account in | | |
| | below par | Allowance | British Troops | each Year | In Rupees | In Sterling at 1s. 4d. |
| | | | | | Rs. | £ |
| 1894-95 | 3,74,15,000 | 78,02,000 | 37,84,000 | 4,90,01,000 | | |
| 1895-96 | 3,05,91,000 | 87,18,000 | 49,38,000 | 4,42,47,000 | 11,91,86,000 | 7,945,733 |
| 1896-97 | 1,66,48,000 | 48,95,000 | 44,25,000 | 2,59,38,000 | | |

In the midst of such a situation it is no wonder if the faith of the Government in the ultimate stability of the rupee had given way, for we find that in October, 1896, the Financial Member of the Council had personally come to the

conclusion that it would be better in the interest of stability to substitute 15d. for 16d. as the par of exchange between the rupee and gold. But the suggestion was dropped as the rupee showed signs of reaching the gold par, which it did in January, 1898, after a period of full five years of depreciation from the established par.

Between January, 1898, and January, 1917, twice did the rupee fall below its gold par. The year 1907-8 records the second occasion when the parity of the rupee under the exchange standard broke down. The actual rates of exchange prevailing in the market were as follows:—

TABLE XXXI
RATES OF EXCHANGE, LONDON ON INDIA (FROM "THE TIMES")

Par R. = 1s. 4d.

| Date | On Calcutta | | On Bombay | |
|-----------------|-------------|-----------|-----------|-----------|
| | Highest | Lowest | Highest | Lowest |
| 1907. September | 1 4 1/32 | 1 3 31/32 | 1 4 1/32 | 1 3 31/32 |
| October | 1 4 1/32 | 1 3 31/32 | 1 4 1/32 | 1 3 31/32 |
| November | 1 4 | 1 3 23/32 | 1 3 31/32 | 1 3 23/32 |
| December | 1 3 15/16 | 1 3 27/32 | 1 3 15/16 | 1 3 27/32 |
| 1908. January | 1 3 15/16 | 1 3 29/32 | 1 3 15/16 | 1 3 7/8 |
| February | 1 3 31/32 | 1 3 7/8 | 1 3 31/32 | 1 3 7/8 |
| March | 1 3 29/32 | 1 3 27/32 | 1 3 29/32 | 1 3 27/32 |
| April | 1 3 7/8 | 1 3 27/32 | 1 3 27/32 | 1 3 27/32 |
| May | 1 3 7/8 | 1 3 27/32 | 1 3 15/16 | 1 3 27/32 |
| June | 1 3 29/32 | 1 3 27/32 | 1 3 7/8 | 1 3 27/32 |
| July | 1 3 7/8 | 1 3 27/32 | 1 3 7/8. | 1 3 27/32 |
| August | 1 3 29/32 | 1 3 27/32 | 1 3 29/32 | 1 3 27/32 |
| September | 1 3 31/32 | 1 3 29/32 | 1 3 31/32 | 1 3 7/8 |
| October | 1 3 15/16 | 1 3 7/8 | 1 3 29/32 | 1 3 13/16 |
| November | 1 3 29/32 | 1 3 7/8 | 1 3 7/8 | 1 3 7/8 |
| December | 1 3 15/16 | 1 3 29/32 | 1 3 31/32 | 1 3 1/8 |

After a crisis lasting over a year the rupee recovered to its old gold par and remained fixed at it, though by no means firmly, for another seven years, only to suffer another fall from its parity during the year 1914-15 (see table, p. XXXII).

After 1916 the stability of the exchange standard was threatened by a danger arising from quite unsuspected quarters. The Indian exchange standard was based upon the view that the gold value of silver was bound to fall or at least not likely to rise to a level at which the intrinsic value of the rupee became

higher than its nominal value. The price of silver at which the intrinsic value of the rupee equalled its nominal value was 43d. per ounce.

TABLE XXXII
RATES OF EXCHANGE, LONDON ON CALCUTTA (FROM THE NATIONAL
BANK OF INDIA)

| Month | 1914 | | 1915 | |
|-----------|-----------|-----------|-----------|-----------|
| | Highest | Lowest | Highest | Lowest |
| January | | | 1 3 15/16 | 1 3 15/16 |
| February | | | 1 4 1/32 | 1 3 29/32 |
| March | | | 1 4 | 1 3 15/16 |
| April | | | 1 3 15/16 | 1 3 29/32 |
| May | 1 4 1/4 | 1 3 15/16 | 1 3 15/16 | 1 3 7/8 |
| June | 1 3 31/32 | 1 3 15/16 | 1 3 7/8 | 1 3 27/32 |
| July | 1 3 31/32 | 1 3 13/16 | 1 3 22/32 | 1 3 23/32 |
| August | 1 3 7/8 | 1 3 13/16 | 1 3 15/16 | 1 3 27/32 |
| September | 1 3 15/16 | 1 3 13/16 | 1 4 | 1 3 15/16 |
| October | 1 3 15/16 | 1 3 15/16 | | |
| November | 1 3 15/16 | 1 3 15/16 | | |
| December | 1 3 15/16 | 1 3 15/16 | | |

So long as the intrinsic value of the rupee remained below its nominal value, i.e. the price of silver did not rise above 43d., there was no danger of the rupee circulating as currency. Once the price of silver rose above that point the danger of the rupee passing from currency to the melting-pot was imminent. Now, with the exception of a brief period from September, 1904, to December, 1907, the gold price of silver had since 1872 showed a marked tendency to fall. The decline in its price was so continuous and so steady as to create the general impression that the low price had come to stay. Indeed, so firm was the impression that the framers of the exchange standard had never taken into account the contingency of a rise in the price of silver above 43d. So little was it anticipated, that the system was not criticised on this ground by any of the witnesses who deposed before the successive Committees and Commission on Indian currency. But the unexpected may happen, and unfortunately did happen after 1916, and happened suddenly. On February 10, 1914, the cash price in London of silver per ounce of standard fineness was 26 5/8d. It fell to 22 11/16d. on February 10, 1915, and though it jumped to 27d. on the same date in 1916, yet it was below the rupee melting-point. After the last-mentioned date its rise was meteoric. On February 9, 1917, it rose to 37 5/8 d.; on February 8, 1918, to 43d.; and on the same date in 1919 to 48 7/16d., thereby quite overshooting the rupee melting-point. But the price of silver broke all

record when on February 11, 1920, it reached the colossal figure of 89 1/2d. per standard ounce.

The rise in the intrinsic value of the rupee above the nominal value at once raised a problem as to how the rupee could be preserved in circulation. Two ways seemed open for the solution of the problem. One was to scale down the fineness of the rupee, and the other to raise its gold parity. All other countries which had been confronted by a similar problem adopted the former method of dealing with their silver coinage—a method which was successfully tried in the Philippines and the Straits Settlements and Mexico in 1904-7, when a rise in those years in the price of silver had created a similar problem in those countries. The Secretary of State for India adopted the second course of action and kept on altering the rupee par with every rise in the price of silver. The alterations of the rupee par following upon the variations in the price of silver are given below:—

TABLE XXXIII

| Date of Alteration of the Rupee Par. | Pitch of the Par. | |
|--------------------------------------|-------------------|-------|
| | s. | d. |
| January 3, 1917 | 1 | 4 1/4 |
| August 28, 1917 | 1 | 5 |
| April 12, 1918 | 1 | 6 |
| May 13, 1919 | 1 | 8 |
| August 12, 1919 | 1 | 10 |
| September 15, 1919 | 2 | 0 |
| November 22, 1919 | 2 | 2 |
| December 12, 1919 | 2 | 4 |

After having played with the rupee par, for two years, in this manner, as though such alterations involved no social consequences, the Secretary of State, on May 30, 1919, appointed a new Currency Committee under the chairmanship of Babington Smith, to recommend measures "to ensure a stable gold exchange standard." The majority of the Committee, after half a year of cogitation, reported to the effect that

" (i) The object should be to restore stability to the rupee, and to re-establish the automatic working of the currency system at as early a date as practicable.

" (ii) The stable relation to be established should be with gold and not with sterling.

"(iii) The gold equivalent of the rupee should be sufficiently high to give assurance, so far as is practicable, that the rupee, while retaining its present weight and fineness, will remain a token coin, or in other words, that the bullion value of the silver it contains will not exceed its exchange value.

"After most careful consideration" (the Committee said) "we are unanimous (with the exception of one of our members who signs a separate report) in recommending that the stable relation to be established between the rupee and gold should be at the rate of one rupee to 11.30016 grs. of fine gold both for foreign exchange and internal circulation." i.e. the rupee to be equal to 2s. (gold).

The minority report, which harped on the old cry of a stimulus of low exchange and penalty of high exchange, stood out for the maintenance of the old rate of 15 rupees to the gold sovereign or 1 13.0016 grs. troy of pure gold, and recommended the issue of a two-rupee silver coin of reduced fineness compared with the old rupee, so long as the price of silver in New York was over 92 cents.

By the announcements of February 2, 1920, the recommendations of the majority of the Committee were accepted by the Secretary of State and also by the Government of India, which abandoned the old parity of 7.53344 grs. per rupee for the new parity of 11.30016 grs. troy. Now, has the rupee maintained its new parity with gold ?

In the matter of ascertaining this fact the exchange quotation on London is no guide, for the value of the rupee was 2s. *gold* and not 2s. sterling. Had gold and sterling been identical the case would have been otherwise. But during the war, owing to the issue of virtually inconvertible money, the pound sterling had depreciated in terms of gold. We must therefore take as our standard a currency which had kept its par with gold. Such a currency was the American dollar, and the exchange quotation on New York is therefore more directly helpful in measuring the gold value of the rupee than is the sterling quotation on London. We can also employ the actual rupee-sterling quotation as a measure by comparing it with the amount of sterling the rupee should have purchased, as an equivalent of 11.30016 grs. of fine gold, when corrected by the prevailing cross-rate between New York and London

Compared with the par of exchange, the actual exchange, either on New York or on London, indicates a fall of the rupee which is simply staggering (See table XXXIV).

Consider, along with the external gold value of the rupee, its internal value in terms of sovereigns and bar gold (see table XXXV).

The tables need no comment. The rupee is not only far away from 2s. (gold), but is not even 1s. 4d. (sterling).

Do not the facts furnish an incontrovertible proof of the futility of the exchange standard ? How can a system which fails to maintain its value in terms of gold, which it is supposed to do, be regarded as a sound system of currency ? There must be somewhere some weakness in the mechanism of a system which is

liable to such occasional breakdowns. The rupee fell or rather was below par in 1893, and did not reach its parity to any real degree of firmness until 1900. After an interval of seven years the rupee again falls below par in 1907. The year 1914 witnesses another fall of the rupee. A meteoric rise since 1917, and again a fall after 1920. This curious phenomenon naturally raises the question : Why did the rupee fail to maintain its gold parity on these occasions ? A proper reply to this question will reveal wherein lies the weakness of the exchange standard.

TABLE XXXIV
ACTUAL GOLD VALUE OF THE RUPEE AND THE NEW PARITY IN
TERMS OF FOREIGN EXCHANGES

| As in the Middle of | New York on Bombay in cents. | | | | | | Bombay on London in s. d. | | | | | |
|------------------------|------------------------------|--------|--------|--------|--------|--------|---------------------------|---------------|-----------|----------|--------------|-----------|
| | 1920. | | 1921. | | 1922. | | 1920. | | 1921. | | 1922. | |
| | Par | Actual | Par | Actual | Par | Actual | Par | Actual | Par | Actual | Par | Actual |
| | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. | Rate. |
| January | 0.4866 | 0-4400 | 0-4866 | 0-2925 | 0-4866 | 0-2800 | 2 7 1/2 | 2 3 5/8 | 2 7 5/16 | 1 5 5/8 | 2 3 5/8 | 1 3 13/16 |
| February | 0.866 | 0-4850 | 0-4866 | 0-2800 | 0-4866 | 0-2845 | 2 10 1/3 1/2 | 2 9 1/8 | 2 5 13/16 | 1 4 1/8 | 2 2 7/32 | 1 3 9/16 |
| March | 0-4866 | 0-4850 | 0-4866 | 0-2625 | 0-4866 | 0-2787 | 2 7 2/3 9/2 | 2 5 3/4 | 2 5 31/32 | 1 3 1/4 | 2 2 29/32 | 1 3 5/16 |
| April | 0-4866 | 0-4775 | 0-4866 | 0-2625 | 0-4866 | 0-2785 | 2 5 7/16 | 2 31 | 2 5 13/16 | 1 3 5/8 | 2 2 1/2 | 1 3 1/8 |
| May. | 0-4866 | 0-4325 | 0-4866 | 0-2675 | 0-4866 | 0-2930 | 2 6 1/3 9/2 | 2 2 1/8 | 2 5 7/32 | 1 3 1/2 | 2 2 1/4 | 1 3 9/16 |
| June | 0-4866 | 0-4125 | 0-4866 | 0-2525 | 0-4866 | 0-2900 | 2 5 3/3 1/2 | 1 10 13/16 | 2 6 29/32 | 1 3 3/8 | 2 2 1/8 | 1 3 19/32 |
| July. | 0-4866 | 0.3900 | 0-4866 | 0-2400 | 0-4866 | 0-2900 | 2 5 3/3 1/2 | 1 8 1/16 | 2 8 9/32 | 1 3 1/4 | 2 2 5/8 | 1 3 5/8 |
| August | 0-4866 | 0-3650 | 0-4866 | 0-2475 | 0-4866 | 0-2916 | 2 8 3 9/32 | 1 10 1/16 | 2 7 29/32 | 1 43/4 | 2 2 3/16 | 1 3 19/32 |
| September | 0-4868 | 0-3325 | 0-4866 | 0-2675 | 0-4866 | 0-2875 | 2 9 9/16 | 1 10 1/16 | 2 7 15/32 | 1 5 1/16 | 2 2 6/16 | 1 3 9/16 |
| October | 0-4866 | 0-3025 | 0-4866 | 0-2825 | 0.4866 | — | 2 9 21/32 | 1 7 3/4 | 2 6 1/32 | 1 5 7/16 | — | — |
| November | 0-4866 | 0-3025 | 0-4866 | 0-2695 | 0-4866 | — | 2 10 9/16 | 1 7 1/8 | 2 5 16/32 | 1 4 1/8 | — | — |
| December | 0-4866 | 0-2650 | 0-4866 | 0-2775 | 0-4866 | — | 2 9 9/16 | 1 5 1/4 | 2 4 | 1 3 7/8 | — | — |

TABLE XXXV
GOLD VALUE OF THE RUPEE AND THE NEW PARITY IN TERMS OF
THE PRICE OF SOVEREIGNS AND GOLD

| | 1920 | | 1921 | | 1922 | |
|--|------|-----------------|------|----------|------|----------|
| | | Price of Bar | | Price of | | Price of |
| | | | | | | |

| Months | Price of British Sovereigns Par 10 Rs. = 1 Sov. | Gold per Tola 100 touch Par Rs. 15-14-10 =1 Tola | Price of British Sovereigns Par 10 Rs. = 1 Sov. | Gold per Tola 100 touch Par Rs. 15-14-10 =1 Tola | Price of British Sovereigns Par 10 Rs. = 1 Sov. | Gold per Tola 100 touch Par Rs. 15-14-10 =1 Tola |
|-----------|---|--|---|--|---|--|
| | Rs. A. P. | RS. A. P. | RS. A. p. | Rs. A. P. | Rs. A. P. | |
| January | Nominal | 28 0 0 | Nominal | Official Figures Not Yet Published | 17 14 0 | Official figures not yet published |
| February | " | 22 0 0 | | | 17 14 0 | |
| March | " | 24 0 0 | | | 17 14 0 | |
| April | " | 24 8 0 | 18 12 0 | | | |
| May | " | 22 12 0 | 19 0 0 | | | |
| June | " | 22 4 0 | 19 12 0 | | | |
| July | " | 23 0 0 | 20 9 0 | | | |
| August | " | 21 8 0 | 20 9 0 | | | |
| September | " | 25 4 0 | 19 2 0 | | | |
| October | " | 27 6 0 | 18 14 0 | | | |
| November | " | 28 10 0 | 18 8 0 | | | |
| December | " | 27 12 0 | 18 6 0 | | | |

The only scientific explanation sufficient to account for the fall of the rupee would be to say that the rupee had lost its general purchasing power. It is an established proposition that a currency or unit of account will be valued in terms of another currency or unit of account for what it is worth, i.e. for the goods which it will buy. To take a concrete example, Englishmen and others value Indian rupees inasmuch and in so far as those rupees will buy Indian goods. On the other hand, Indians value English pounds (and other units of account, for that matter) inasmuch and in so far as those pounds will buy English goods. If rupees in India rise in purchasing power (i.e. if the Indian price-level falls) while pounds fall in purchasing power or remain stationary or rise less rapidly (i.e. if the English price level rises relative to the Indian price-level), fewer rupees would be worth as much as a pound, i.e. the exchange value of the rupee in terms of the pound will rise. On the other hand, if rupees in India fall in purchasing power (i.e. if the Indian price-level rises) while pounds rise in purchasing power or remain stationary or fall less rapidly (i.e. if the English price-level falls relative to the Indian price-level), it will take more rupees to be worth as much as a pound, i.e. the exchange value of the rupee in terms of the pound will fall.

On the basis of this theory the real explanation for a fall in the Indian exchange should be sought for in the movement of the Indian price-level. Lest

there be any doubt regarding the validity of the proposition let us take each of the occasions of the fall and find out whether or not the fall was coincident with the fall in the purchasing power of the rupee.

TABLE XXXVI
PERIOD 1, 1890-99

| Years | Currency in Circulation Rupees + Notes | | Index Number of prices in India 1890- 94 = 100 | Index Number of prices in England 1890-94 = 100 |
|-------|---|-------------------------------------|--|---|
| | Amount in Crores of Rs. | Index Number 1890-94 = 100 | | |
| (1) | (2) | (3) | (4) | (5) |
| 1890 | 120 | 92 | 113 | 104 |
| 1891 | 131 | 100 | 106 | 105 |
| 1892 | 141 | 108 | 100 | 99 |
| 1893 | 132 | 101 | 96 | 99 |
| 1894 | 129 | 99 | 85 | 93 |
| 1895 | 132 | 101 | 89 | 90 |
| 1896 | 127 | 97 | 99 | 89 |
| 1897 | 125 | 96 | 120 | 90 |
| 1898 | 122 | 93 | 109 | 91 |
| 1899 | 131 | 100 | 108 | 94 |

TABLE XXXVII
PERIOD II, 1900-1908

| Years | Currency in Circulation Rupees + Notes | | Index Number of prices in India 1890-94 = 100 | Index Number of prices in England 1890-94 = 100 |
|-------|--|-------------------------------------|--|---|
| | Amount in Crores of Rs. | Index Number 1890-94 = 100 | | |

| (1) | (2) | (3) | (4) | (5) |
|------|-----|-----|-----|-----|
| 1900 | 134 | 103 | 126 | 103 |
| 1901 | 150 | 115 | 120 | 98 |
| 1902 | 143 | 109 | 115 | 96 |
| 1903 | 147 | 113 | 111 | 97 |
| 1904 | 152 | 116 | 110 | 100 |
| 1905 | 164 | 126 | 120 | 100 |
| 1906 | 185 | 142 | 134 | 107 |
| 1907 | 190 | 145 | 138 | 113 |
| 1908 | 181 | 139 | 147 | 104 |

TABLE XXXVIII
PERIOD III, 1909-14

| Years | Currency in Circulation Rupees + Notes | Index Number of prices in India 1890- 94 = 100 | Index Number of prices in England 1890-94 = 100 | |
|-------|---|--|--|-----|
| | Amount in Crores of Rs. | index Number 1890-94 = 100 | | |
| (1) | (2) | (3) | (4) | (5) |
| 1909 | 198 | 152 | 138 | 105 |
| 1910 | 199 | 152 | 137 | 110 |
| 1911 | 209 | 160 | 139 | 114 |
| 1912 | 214 | 164 | 147 | 117 |
| 1913 | 238 | 182 | 152 | 124 |
| 1914 | 237 | 182 | 156 | 124 |

TABLE XXXIX
PERIOD IV, 1915-1921

| Years | Currency in Circulation Rupees + Notes | Index Number of prices in India 1913=100 | index Number of prices in England 1913= 100 |
|-------|---|--|---|
|-------|---|--|---|

| | Amount in Crores of Rs. | Index Number 1913 =100 | | |
|------|-------------------------------|------------------------------|-----|-------|
| (1) | (2) | (3) | (4) | (5) |
| 1915 | 266 | 104 | 112 | 127.1 |
| 1916 | 297 | 116 | 125 | 159.5 |
| 1917 | 338 | 132 | 142 | 206.1 |
| 1918 | 407 | 155 | 178 | 226.5 |
| 1919 | 463 | 180 | 200 | 241.9 |
| 1920 | 411 | 160 | 209 | 295.3 |
| 1921 | 393 | 114 | 183 | 182.4 |

Now do these tables confirm, or do they not, the argument that the fall in the gold value of the rupee is coincident with a fall in the general purchasing power of the rupee ? What was the general purchasing power of the rupee when a fall in its gold value occurred ? if we scrutinise the facts given in the above tables in the light of this query there can be no doubt as to the validity of this argument. From the tables it will be seen that the gold value of the rupee improved between 1893-1898 because there was a steady, if not unbroken, improvement in its general purchasing power. Again, on the subsequent occasions when the exchange fell, as it did in 1908, 1914, and 1920, it will be observed that these were the years which marked the peaks in the rising price-level in India ; in other words, those were the years in which there was the greatest depreciation in the general purchasing power of the rupee. A further proof, if it be needed, of the argument that the exchange value of the rupee must ultimately be governed by its general purchasing power is afforded by the movements of the rupee-sterling exchange since 1920 (see Table XL).

But, although such is the theoretical view confirmed by statistical evidence of the causes which bring about these periodic falls in the gold value of the rupee (otherwise spoken of as the fall of exchange), it is not shared by the Government of India. The official explanation is that a fall in the gold value of the rupee is due to an adverse balance of trade. Such is also the view of eminent supporters of the exchange standard like Mr. Keynes and Mr. Shirras.

No doubt, some such line of reasoning is responsible for the currency fiasco of 1920. How is it possible otherwise to explain the policy of raising the exchange value of the rupee ? Both the Smith Committee on Indian Currency* and the Government of India were aware of the fact that the rupee was heavily depreciated, as evidenced by the rise of prices in India.

TABLE XL

| Date | Rupee Prices in India. 1913=100 | Sterling Price in England (<i>Statist.</i>). 1913=100 | Average Rate of Exchange London on Calcutta | Rupee-Sterling Purchasing Power Parity 16d x col.3/col.2 |
|---------------|--|--|--|---|
| (1) | (2) | (3) | (4) | (5) |
| | | | d. | d. |
| 1920. January | 202 | 289 | 27.81 | 22.89 |
| February | 203 | 306 | 32.05 | 24.12 |
| March | 194 | 301 | 29.66 | 25.40 |
| April | 193 | 300 | 27.88 | 25.95 |
| May | 190 | 298 | 25.91 | 25.77 |
| June | 192 | 293 | 23.63 | 25.08 |
| July | 196 | 282 | 22.63 | 24.49 |
| August | 193 | 263 | 22.75 | 24.70 |
| September | 188 | 244 | 22.31 | 24.94 |
| October | 188 | 232 | 19.88 | 24.00 |
| November | 186 | 215 | 19.69 | 22.62 |
| December | 179 | 209 | 17.44 | 21.81 |
| 1921. January | 169 | 200 | 17.66 | 21.96 |
| February | 164 | 191 | 16.31 | 20.98 |
| March | 162 | 183 | 15.53 | 20.40 |
| April | 163 | 186 | 15.75 | 19.63 |
| May | 170 | 182 | 15.44 | 17.98 |
| June | 172 | 178 | 15.53 | 17.14 |
| July | 171 | 163 | 15.38 | 17.40 |
| August | 178 | 161 | 16.25 | 16.36 |
| September | 178 | 157 | 17.22 | 15.82 |
| October | 178 | 156 | 17.02 | 14.65 |
| November | 173 | 161 | 16.25 | 14.89 |
| December | 169 | 157 | 15.94 | 14.86 |
| 1922. January | 162 | 156 | 15.88 | 15.41 |
| February | 159 | 156 | 15.59 | 16.70 |
| March | 160 | 157 | 15.34 | 15.70 |
| April | 160 | 159 | 15.19 | 15.90 |
| May | 162 | 159 | 15.59 | 15.70 |
| June | 169 | 160 | 15.63 | 15.14 |
| July | 170 | 158 | 15.69 | 14.87 |

| | | | | |
|--------|-----|-----|-------|-------|
| August | 166 | 153 | 15.66 | 14.74 |
|--------|-----|-----|-------|-------|

Given this fact, any question of raising the gold value of the rupee to 2s. gold when the rupee had scarcely the power to purchase 1s. 4d. sterling was out of the question. The Committee indulged in loose talk about stabilising the Indian exchange. But even from this standpoint the Committee's insistence on linking the rupee to gold must be regarded as little grotesque. Stable exchange, to use Prof. Marshall's language, is something like bringing the railway gauges of the world in unison with the main line. If that is what is expected from a stable exchange, then what was the use of linking the rupee to gold which had ceased to be the " main line " ? What people wanted was a stable exchange in terms of the standard in which prices were measured. Linking to gold involved unlinking to sterling, and it is sterling which mattered and not gold. Given this importance of sterling over gold, was any policy of exchange stabilisation called for ? First of all it should have been grasped that such a policy could succeed only if it was possible to make sterling and rupee prices move in unison, for then alone could the ratio of interchange between them be the same. What control had the Government of India over the sterling ? They might have so controlled the rupee as to produce the effect desired, but all that might have been frustrated by an adverse move in the sterling. The success of the policy of linking to sterling would have been highly problematical although highly desirable. But was it called for ?

Now the problem of stabilisation is primarily a problem of controlling abnormal deviations from the purchasing-power parity between two currencies. In the case of India there were no abnormal deviations from the rupee-sterling purchasing-power parity. On the other hand, the Indian exchange was moving in a more or less close correspondence with it. There was therefore no ground for originating any policy of exchange stabilisation. But, supposing there were abnormal deviations and that, owing to some reasons known to it, the Committee believed that the exchange value of the rupee was not likely to return to the point justified by its general purchasing power, in that case the Committee should have fixed the exchange value well within the range of the purchasing power of the rupee. As it was, the value of the rupee fixed by the Committee the rupee never had. In giving a value to the rupee so much above its purchasing-power parity, it is obvious the Committee originated a solution for the simple problem of stabilising the rupee which involved the much bigger and quite a different problem of deflation or raising the absolute value of the rupee. How was the object to be attained ? The Committee never considered that problem. And why ? Was it because the price of silver had gone up ? May be. But it is doubtful whether the Committee could have believed firmly that the

value of silver was going to be permanently so high as to require a modification of the gold par. Anyone who cared to scrutinise the rise in the price of silver could have found that the rise was largely speculative and could not have been permanent.

TABLE XLI
PRICE OF SILVER IN STERLING (PENCE)

| Year | Highest | Lowest | Average | Range of Variation |
|------|---------|----------|----------|--------------------|
| 1913 | 29 3/8 | 25 15/16 | 27 9/16 | 3 7/16 |
| 1914 | 27 3/4 | 22 1/8 | 25 5/16 | 5 5/8 |
| 1915 | 27 1/4 | 22 5/16 | 23 11/16 | 4 15/16 |
| 1916 | 37 1/8 | 26 11/16 | 31 5/16 | 10 7/16 |
| 1917 | 55 | 35 11/16 | 40 7/8 | 19 11/16 |
| 1918 | 49 1/2 | 42 1/2 | 47 9/16 | 7 |
| 1919 | 79 1/8 | 47 3/4 | 57 1/16 | 31 3/8 |
| 1920 | 89 1/2 | 38 7/8 | 61 7/16 | 50 5/8 |
| 1921 | 43 3/8 | 30 5/8 | 37 | 12 3/4 |

But supposing that the rise in the price of silver was not speculative, did it follow that the rupee was appreciated? The diagnosis of the Committee was an egregious blunder. With the facts laid before the Committee it is difficult to understand how anyone with a mere smattering of the knowledge of price movements could have concluded that because silver had appreciated the rupee had therefore appreciated. On the other hand, what had happened was that the rupee had depreciated in terms of general commodities, including gold and silver. indeed, the appreciation of silver was a depreciation of the rupee. The following (Table XLII) is conclusive evidence of that fact —

TABLE XLII
DEPRECIATION OF THE RUPEE

| Date | Price of Bar Gold in India (Bombay) per Tola of 180 grs. | Price of Silver in India (Bombay) per 100 Tolas | Index Number for Prices in India 1913=100 |
|------|--|---|---|
| | Rs. A. | Rs. A. | |
| 1914 | 24 10 | 65 11 | |
| 1915 | 24 14 | 61 2 | 112 |
| 1916 | 27 2 | 78 10 | 125 |

| | | | |
|-------------|-------------|-----------------|-----|
| 1917 | 27 11 | 94 10 | 142 |
| 1918 | (July) 34 0 | (May 16) 117 2 | 178 |
| 1918 | | (Nov. 28) 82 10 | |
| 1918 August | 30 0 | | |
| 1918 Sept. | 32 4 | | |
| 1919 March | 32 0 | 113 0 | 200 |

Thus, the rise in the price of silver was a part of the general rise of prices of the depreciation of the rupee. The Committee desired to raise the gold value of the rupee to 10 rupees per sovereign when it cost twice that number of rupees to purchase a sovereign in the market. So marked was the depreciation of the rupee in terms of gold that a few months before the Committee submitted its report the *Statesman* (a Calcutta paper) wrote —

" If you land in the country with a sovereign the Government will take it away from you and give you eleven rupees three annas in return. If you are in the country and happen to have a sovereign and take it to the currency office you will get fifteen rupees for it. On the other hand, if you take it to the bazar you will find purchasers at twenty-one rupees." These facts were admitted by the Finance Department of the Government of India to be substantially correct, and yet in the face of them the Committee recommended the 2s. gold parity for the rupee. The Committee confused the rupee with the silver, and thus failed to distinguish the problem of retaining the rupee in circulation and raising its exchange value in terms of gold. The latter solution was applicable only if the *rupee* had appreciated. But as it was silver that had appreciated in terms of the rupee, the only feasible solution was to have proposed the reduction of the fineness of the rupee. Had the Committee regarded silver as a commodity distinct from the rupee like any other commodity to be measured in terms of the rupee as a unit of account, probably it might have avoided committing the blunder which it did. But what is more than probable is that the Committee did not think that the general purchasing power of the rupee was a factor of any moment in the consideration of the matter it was asked to report upon. What was of prime importance in its eyes for the maintenance of the exchange value of the rupee was a favourable balance of trade, and that India had at the time the Committee drafted its Report. For the Committee, in the course of its general observations on the exchange standard, remarked:

" that the system had proved effectual in preventing the fall in the value of the rupee below 1s. 4d., and unless there should have been profound modifications in India's position as an exporting country with a favourable trade balance, there was no reason to apprehend any breakdown in this respect."

Proceeding on this view of the question it was quite natural for the Committee

to have argued that if a favourable balance of trade sustained 1s. gold exchange, why should a similar balance of trade not sustain 2s. gold exchange?

Again, it is only on some such hypothesis that one can explain why the recommendations of the Committee were adopted at all when the necessity for their adoption had passed away. Even if the intrinsic value of the rupee exceeded its nominal value, there was no danger of a wholesale disappearance of the rupee from circulation in view of the enormous volume of rupees in India. What would have taken place was not a wholesale melting of rupees, but a constant dribble of an irregular and illegal character leading to the contravention of the orders then issued by the Government of India against the melting or exportation of the rupee coin. At the time when the Committee reported (December, 1919) the price of silver was no doubt high, but it was certainly falling during 1920 when the Government took action on the Report. Indeed, on August 31, 1920, when the Bill to alter the gold value of the rupee was introduced into the Council, gold was selling at 23 1/4 rupees to the tola, while if the sovereign was to be equal to 10 rupees, the market price of gold should have been Rs. 15-14-0 per tola, so that there was a difference of Rs. 7 1/2 or 33 per cent. between the market ratio of gold to the rupee and the new mint ratio. Moreover, the price of silver had also gone down in the neighbourhood of 44d., so that there was no danger of the rupee being melted out of circulation. But, notwithstanding such a disparity, the Government rushed to fix a higher gold parity for the rupee. The financial reason for this rash act was of course obvious. The impending constitutional changes were to bring about a complete separation between provincial and imperial finance in British India. Under the old system of finance it was open for the central Government to levy "benevolences" in the form of contributions on the Provincial Governments to meet such of its imperious wants as remained unsatisfied with the help of its own resources, apart from the lion's share it used to take at every settlement of the provincial finance. Under the new constitution it was to be deprived of this power. The Central Government was therefore in search of some resource to obtain relief without appearing to tax anybody in particular. A high exchange seemed to be just the happy means of doing it, for it was calculated to effect a great saving on the "home charges." But how was this high exchange to be maintained, supposing it was desirable to have a high exchange from the financial point of view? Not only had the price of silver gone down and the rupee shown evident marks of depreciation in terms of gold, but the balance of trade had also become adverse to India at the time when the government proceeded to take action on the Report of the Committee. But this enactment, so singular in its rashness, was none the less founded upon the

hope that the balance of trade would become favourable in time and thus help to maintain the 2s. gold value of the rupee. That this is a correct interpretation of the Government's calculations is borne out by the following extract from the letter which it addressed to the Bengal Chamber of Commerce in explanation of the currency fiasco. After speaking of the necessity for granting international credits to revive commerce, the letter goes on to say:—

" But for the rest they [i.e. the Government of India] can now only rely on the natural course of events and the return of favourable export conditions, combined with the reduction of imports... to strengthen the exchange. Experience has demonstrated that in the present condition of the world trade stability is at present unattainable, but the Government of India see no reason why the operation of natural conditions should not allow of the eventual fixation of exchange at the level advocated in the report of the Currency Committee."

Which of the two views is correct ? Is it the low purchasing power of the rupee which is responsible for its fall, or is it due to an adverse balance of trade ? Now, it must at once be pointed out that an adverse balance of trade, as an explanation of the fall of exchange, is something new in Indian official literature. A fall of exchange was a common occurrence between 1873 and 1893, but no official ever offered the adverse balance of trade as an explanation. Again, can the doctrine of the adverse balance of trade furnish an ultimate explanation for the fall that occurred in 1907, 1914, and 1920? First of all, taking into consideration all the items visible and invisible, the balance-sheet of the trade of a country must balance, indeed, the disquisitions attached to the Indian Paper Currency Reports, wherein this doctrine of adverse balance as a cause of fall in exchange is usually to be found, never fail to insist that there is no such thing as a " drain " from India by showing item by item how the exports of India are paid for by the imports, even in those years in which the exchange has fallen. The queer thing is, the same Reports persist in speaking of an adverse balance of trade. Given the admission that all Indian exports are paid for, it is difficult to see what remains to speak of as a balance. Why should that part of trade liquidated by money be spoken of as a " balance " ? One might as well speak of a balance of trade in terms of cutlery or any other commodity that enters into the trading operations of the country. The extent to which money enters into the trading transactions of two countries is governed by the same law of relative values as is the case with any other commodity. If more money goes out of a country than did previously, it simply means that relatively to other commodities it has become cheaper. But if there is such a thing as an adverse balance in the sense that commodity imports exceed commodity exports, then there arises the further question : Why do exports fall off and imports mount up

? In other words, given a normal equilibrium of trade, what causes an adverse balance of trade ? For this there is no official explanation. Indeed, the possibility of such a query is not even anticipated in the official literature. But the question is a fundamental one. An adverse balance of trade in the above sense is only another way of stating that the country has become a market which is good to sell in and bad to buy from. Now a market is good to sell in and bad to buy from when the level of prices ruling in that market is higher than the level of prices ruling outside. Therefore, if an adverse balance of trade is the cause of the fall of exchange, and if the adverse balance of trade is caused by internal prices being higher than external prices, then it follows that the fall of exchange is nothing but the currency's fall in purchasing power, which is the same thing as the rise of prices. The adverse balance of trade is an explanation a step short of the final explanation. Try to circumvent the issue as one may, it is impossible to escape the conclusion that the fall in the exchange value of the rupee is a resultant of the fall in the purchasing power of the rupee.

Now what is the cause of the fall in the purchasing power of the rupee? In that confused, if not absurd, document, the Report of Price Inquiry Committee, one cause of the rise of prices in India was assigned, among others, to the decline in supplies relatively to population. In view of the more or less generally accepted theory of quantity of a currency as the chief determinant of its value, the line of reasoning adopted by the Committee is somewhat surprising. But there is enough reason to imagine why the Committee preferred this particular explanation of the rise of prices. The position of the Government with regard to the management of the Indian currency is somewhat delicate. Already the issue of paper currency was in the hands of the Government. By the Mint closure it took over the management of the rupee currency as well. Having the entire control over the issue of currency, rupee and paper, the Government becomes directly responsible for whatever consequences the currency might be said to produce. It must not, also, be forgotten that the Government is constantly under fire from an Opposition by no means over-scrupulous in the selection of its counts. As a result of this situation the Government walks very warily, and is careful as to what it admits. Lord Castlereagh, in the debate on Homer's resolution of 1811 stating that bank notes were depreciated by over-issue, asked the House of Commons to consider what Napoleon would do if he found the House admitting the depreciation even if it was a fact. The Government of India is in the same position, and had to think what the Opposition would do if it admitted this or that principle. The reason why the Government of India adheres to the adverse balance of trade as an explanation of the fall of exchange is the same which led the Committee to ascribe the rise of prices to the shortage of goods. Both the doctrines have the virtue of placing the events

beyond the control of the Government and thus materially absolving the Government from any blame that might be otherwise cast upon it. What can the Government do if the balance of trade goes wrong ? Again, is it a fault of the Government if the supply of commodities declines ? The Government can move safely under the cover of such a heavy armour! But does the explanation offered by the Committee invalidate the explanation that the cause of the rise of prices in India was excess of currency ? The value of money is a resultant of an equation (of exchange) between money and goods. To that equation there are obviously two sides, the money side and the commodity side. It is an age-worn dispute among economists as to which of the two is the decisive factor when the result of the equation of exchange undergoes a change, i.e. when the general price-level changes. There are economists who when discussing the value or the general purchasing power of money emphasise the commodity side in preference to the money side of the equation as the chief determinant of it. To them if prices in general fall it may not be due to scarcity of money ; on the other hand, it may be due to an increase in the volume of commodities. Again, if prices in general rise they prefer to ascribe it to a decrease in the volume of commodities rather than to an increase in the quantity of money. It is possible to take this position, as some economists choose to do, but to imagine that the quantity theory of money is thereby overthrown is a mistake. As a matter of fact, in taking that position they are not damaging the quantity theory in the least. They are merely stating it differently. The weakness of the position consists in failing to take note of what the effect on the general price-level would be if in speaking of increase or decrease of commodities they *included* a corresponding increase or decrease of currency. If the volume of commodities increases, including the volume of currency, then there is no reason why general prices should fall. Similarly, if the volume of commodities decreases, including the volume of currency, then there is no reason why general prices should fall. Similarly, if the volume of commodities decreases, including the volume of currency, then there is no reason why general prices should rise. The commodity explanation is but the reverse side of the quantity explanation of the value of money. Recasting the argument of the Committee in the light of what is said above, we can say without departing from its language that the rise of prices in India was due to the supply of currency not having diminished along with the diminution in the supply of goods. In short, the rupee fell in purchasing power because of currency being issued in excess, and there is scarcely any doubt that there has been a profuse issue of money in India since the closing of the Mints in 1893.

The first period, from 1893-98 was comparatively speaking the only period marked by a rather halting and cautious policy in respect of currency

expansion. The reason no doubt was the well-known fact that at the time the Mints were closed the currency was already redundant. Yet the period was not immune from currency expansion. At the time the Mints were closed the silver bullion then in the hands of the people was depreciated as a result of the fall in its value due to the closure. An agitation was set up by interested parties to compel the Government to make good the loss. Ultimately, the Government was prevailed upon by Sir James Mackay (now Lord Inchcape), the very man who forced Government to close the Mints, to take the silver from the banks. The Government proposed to the Secretary of State that they be allowed to sell the silver even at a loss rather than coin and add to the already redundant volume of currency. The Secretary of State having refused, the silver was coined and added to the currency. The stoppage of Council Bills in 1893-94 had temporarily accumulated a large number of rupees in their Treasuries, a transaction which practically amounted to a contraction of currency. But the Government later decided to spend them on railway construction—a policy tantamount to an addition to currency. The resumption of Council Bills after 1894 had also the same effect, for a sale of bills involves an addition to currency. In view of the heavy cost of financing the Home Treasury by gold borrowings, the resumption of sale was a pardonable act. But what was absolutely unpardonable was the increase in the fiduciary portion of the paper-currency reserve from 8 to 10 crores. thereby putting 2 crores of coined rupees into circulation, particularly so because the Finance Minister refused to pay any heed to its incidence on the currency policy, arguing:—

" I am a little doubtful whether, in discussing the question of the investment of the currency reserve, we are at liberty to look at outside considerations of that kind." All told, the additions to the currency during the first period were negligible as compared to what took place in the second period, 1900-1908. This period was characterised by a phenomenal increase in the volume of currency poured by the Government into circulation. Speaking of the coinage of rupees during this period, Mr. Keynes, anything but an unfriendly critic of the Government's policy observed —

"The coinage of rupees recommenced on a significant scale in 1900 a steady annual demand for fresh coinage (low in 1901-2, high in 1903-4, but at no time abnormal), and the Mints were able to meet it with time to spare, though there was some slight difficulty in 1903-4. In 1905-6 the demand quickened, and from July 1905 it quite outstripped the new supplies arising from the mintage of the uncoined silver... This slight scare, however, was more than sufficient to make the Government lose their heads. Having once started on a career of furious coinage, they continued to do so with little regard to considerations of ordinary prudence... without waiting to see how

the busy seasons of 1906-7 would turn out, they coined heavily throughout the summer months... During the summer of 1907, as in the summer of 1908, they continued to coin without waiting until the prosperity of the season 1907-8 was assured."

Evidently, in this period the Government framed their policy "as though a community consumed currency with the same steady appetite with which some communities consume beer." The period also witnessed a material expansion of the paper currency. Up to 1903 the use of the currency notes was limited by reason of the fact that they were not only legal tender outside their circle of issue, but also because their encashability was restricted to the offices of the circles of their issue. This was a serious limitation on the extension of paper currency in India. by Act VI of 1903 the Rs. 5 was made universal in British India excepting Burma, i.e. was made legal tender in all circles, and also encashable at all offices of issue. Along with this the fiduciary portion of the paper-currency reserve was increased to Rs. 12 crores by Act III of 1905. The first event was only calculated to enlarge the circulation of the notes, but the second event had the direct effect of lowering the value of the rupee currency.

The third period (1909-14) was comparatively a, moderate but by no means a slack period from the standpoint of currency expansion in India. The first three years of the period were, so to say, years of subdued emotion with regard to the rupee coinage. With the exception of the year 1910, when there was no net addition to rupee coinage, and 1911, when the addition was a small one, the coinage in the years 1909 and 1912 ranged from 24 to 30 lakhs. But during the last two years of this period there was a sudden burst of rupee coinage, when the total reached 26 1/2 crores. The expansion of paper currency took place also on a great scale during this period. In 1909 the Rs. 5 were universalised in Burma as they had previously been in other parts of India. This process of universalisation was carried further during this period, when, under the authority granted by the Paper Currency Act (II of 1910), the Government universalised notes of Rs. 5 and Rs. 50 in 1910, of Rs. 100 in 1911. Along with the stimulus thus given to the increase of paper currency, the Government actually expanded the fiduciary portion of the issue from 12 to 14 crores by Act VII of 1911, thereby throwing into circulation 2 crores of additional rupees.

During the fourth period (1915-1920) all prudential restraints were thrown overboard. The period coincided with the Great War, which created a great demand for Indian produce and also imposed upon the Government the necessity for meeting large expenditure on behalf of H. M. Government. Both these events necessitated a great increase in the current means of purchase. There were three sources open to the Government to provide for the need: (1) importation of gold; (2) increase of rupee coinage; and (3) increase of paper

currency. It must not be supposed that the Government of India had no adequate means to provide the necessary currency. Whatever expenditure the Government of India incurred in India, the Secretary of State was reimbursed in London. So the means were ample. The difficulty was that of converting them to proper account. Ordinarily, the Secretary of State purchases silver out of the gold at his command to be coined in India into rupees. This usual mode was followed for the first two years of the period, and the currency was augmented by that means. But the rise in the price of silver made that resource less available. The Secretary of State had therefore to choose between sending out gold or issuing paper. Of the two, the former was deemed to be too unpatriotic. Indeed, the Secretary of State believed that from an Imperial point of view it was entirely ungracious even to " earmark " the gold he received in London as belonging to India. But how was demand for additional currency in India to be met ? As a result of deliberation it was agreed that to provide currency in India without employing gold the best plan was for the Secretary of State to invest at one end the gold he received on India's behalf in the purchase of British Treasury bills, and the Indian Government to issue currency notes at the other end on the security of these bills. Such a procedure, it will be observed, involved a profound modification in the basic theory of Indian paper currency. That theory was to increase the fiduciary issue by investing a portion of the metallic reserves only when the proportion of the latter to the total of the notes in active circulation had shown, over a considerable period, a position sufficiently strong to warrant an extension of the invested reserves and a corresponding diminution of the metallic reserves. The main effect of the principle was that the extent of the paper currency was strictly governed by the habits of the people, for whatever the amount of fiduciary issue at any given moment it represented metallic reserves which were once in existence. Under the new scheme the old principle was abandoned and paper currency was issued without any metallic backing, and what is more important is that its magnitude instead of being determined by the habits of the people, was determined by the necessity of the Government and the amount of security it possessed. This fatal and facile procedure was adopted by the Government of India with such avidity that within four years it passed one after another eight Acts, increasing the volume of notes issuable against securities. The following table gives the changes in the limits fixed by the Acts and the total issues actually made under them :—

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